

## Message Text

CONFIDENTIAL

PAGE 01 STATE 110561  
ORIGIN CEA-01

INFO OCT-01 EUR-12 EA-10 IO-13 ISO-00 AGRE-00 CIAE-00  
COME-00 DODE-00 EB-08 FRB-03 H-01 INR-10 INT-05  
L-03 LAB-04 NSAE-00 NSC-05 PA-01 CTME-00 AID-05  
SS-15 STR-07 ITC-01 TRSE-00 ICA-11 SP-02 SOE-02  
OMB-01 DOE-15 OES-07 CEQ-01 ACDA-12 XMB-02 /158 R

DRAFTED BY CEA:JSHAFFER  
APPROVED BY EA/J:NPLATT  
EUR/RPE:RGELBARD (INFO)  
EA/EP:JSHINN  
DESIRED DISTRIBUTION  
E, EP, EB, CEA, TREASURY  
-----125646 012146Z /61

R 012033Z MAY 78  
FM SECSTATE WASHDC  
TO AMEMBASSY TOKYO  
INFO AMEMBASSY PARIS  
USMISSION GENEVA  
AMEMBASSY BRUSSELS  
AMEMBASSY LONDON  
AMEMBASSY BONN

C O N F I D E N T I A L STATE 110561

PARIS FOR USOECD, GENEVA FOR US MTN, BRUSSELS FOR USEC

E.O. 11652: GDS

TAGS: ECON, EFIN, JA, US

SUBJECT: CEA TALKS WITH ECONOMIC PLANNING AGENCY, APRIL 14-15

1. SUMMARY. FIRST DAY OF CEA/EPA TALKS DEVOTED TO AN EX-CHANGE OF VIEWS ON ECONOMIC DEVELOPMENTS IN U.S., JAPAN  
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 STATE 110561

AND WORLD ECONOMY. SECOND DAY CONCENTRATED ON ENERGY AND EFFECTS OF YEN APPRECIATION. DISCUSSIONS TOOK PLACE IN A FRIENDLY, BUSINESSLIKE ATMOSPHERE WITH BULK OF TIME DEVOTED TO DETAILED ASSESSMENTS OF ECONOMIC TRENDS. JAPANESE SIDE EXPRESSED STRENGTHENED CONVICTION THAT ITS 7 PERCENT GROWTH TARGET WOULD BE ACHIEVED BUT CONCERN THAT RENEWED YEN APPRECIATION MIGHT DELAY CURRENT ACCOUNT OBJECTIVES. STRONG

INTEREST WAS EXPRESSED IN OUTLOOK FOR U.S. PETROLEUM IMPORTS. END SUMMARY.

2. IN LEAD-OFF SESSION MORNING OF APRIL 14, CEA CHAIRMAN SCHULTZ SUMMARIZED U.S. ECONOMIC SITUATION AS BEING CHARACTERIZED BY SUBSTANTIAL BUT STILL INCOMPLETE RECOVERY FROM RECESSION, FALLING BUT STILL HIGH UNEMPLOYMENT, PERSISTENT UNDERLYING INFLATION OF AROUND 6 PCT, AND A LARGE PAYMENTS DEFICIT DUE TO DOMESTIC DEMAND GROWTH ABOVE THE WORLD AVERAGE COMBINED WITH A RISING OIL IMPORT BILL. HE EMPHASIZED THAT INFLATED OIL IMPORTS REFLECT PRIMARILY REDUCED DOMESTIC PRODUCTION AND HIGH PRICES, AS DOMESTIC CONSUMPTION

IS RUNNING BELOW PRE-OIL-CRISIS TRENDS. SCHULTZ SAID U.S. POLICIES WERE AIMED AT ATTAINING SUFFICIENT GROWTH TO BRING DOWN UNEMPLOYMENT, REDUCING STRUCTURAL UNEMPLOYMENT, MINIMIZING RISKS OF REACCELERATION OF INFLATION AND PURSUING A VOLUNTARY INCOMES POLICY TO REDUCE THE UNDERLYING INFLATION. MINISTER MIYAZAWA EXPRESSED CONSIDERABLE INTEREST IN U.S. PROJECTION THAT OIL IMPORTS IN 1978 WOULD BE ROUGHLY UNCHANGED FROM 1977.

3. IN AFTERNOON SESSION, MIYAZAKI, DIRECTOR GENERAL COORDINATION BUREAU, MADE THE PRESENTATION FOR EPA OF THE JAPANESE ECONOMIC SITUATION. MIYAZAKI REVIEWED POST OIL-SHOCK DEVELOPMENTS SAYING THAT ALTHOUGH JAPAN HAD BEEN CONFIDENTIAL

CONFIDENTIAL

PAGE 03 STATE 110561

ABLE TO ADJUST BETTER THAN MOST INDUSTRIAL COUNTRIES TO THE TRILEMMA OF HIGH OIL COSTS, INFLATION AND RECESSION PROBLEMS REMAIN, PARTICULARLY IN DOMESTIC UNEMPLOYMENT AND THE EXTERNAL SURPLUS. THESE PROBLEMS WERE WHAT HAD PROMPTED THE GOVT TO SET A 7 PERCENT GROWTH TARGET FOR CY 78 AND ADOPT EXPANSIONARY FISCAL POLICIES. MIYAZAKI SAID HE WAS INCREASINGLY CONFIDENT THE 7 PCT TARGET WOULD BE ACHIEVED. HE EMPHASIZED THAT THE INVENTORY ADJUSTMENT IS LIKELY TO BE COMPLETED BY END OF SPRING RESULTING IN STRONGER IMPACT OF PUBLIC INVESTMENT ON FINAL OUTPUT, THAT RECENT SURVEYS SHOW NON-MANUFACTURING INVESTMENT COMING ALONG IN LINE WITH GOVT'S PROJECTIONS, AND THAT REAL PERSONAL INCOME GROWTH SHOULD AT LEAST MATCH THE GOVT'S PROJECTIONS SINCE BETTER-THAN-PREDICTED PRICE PERFORMANCE SHOULD MORE THAN OFFSET LOWER-THAN-ANTICIPATED WAGE SETTLEMENTS. CONFIDENCE IN VIEW WAS MAINTAINED WHEN U.S. CALLED ATTENTION TO PRIVATE FORECASTS, WHICH CLUSTER AROUND GROWTH OF ABOUT 5 PERCENT. HE SAID HE THOUGHT PRIVATE FORECASTERS LAST DEC, JAN AND FEB HAD BEEN OVERLY PESSIMISTIC BECAUSE THEY UNDERESTIMATED PROGRESS ON INVENTORY ADJUSTMENT, HAD NOT FULLY TAKEN ACCOUNT OF EFFECT OF PROGRESSIVE DISCOUNT RATE HIKES, AND HAD EXAG-

GERATED THE DIFFICULTIES OF ADJUSTING TO HIGH YEN. HE NOTED THAT TWO RESEARCH HOUSES HAD RECENTLY REVISED UPWARD THEIR FY 78 FORECAST. (FYI--CEA FINDS THAT DIFFERENT INVENTORY ASSUMPTIONS ACCOUNT FOR VERY LITTLE OF THE DISPARITY BETWEEN EPA AND PRIVATE FORECASTS. MOREOVER, THE FORECASTS THAT WERE NOTED AS HAVING BEEN RAISED HAD BEEN AMONG THE LOWEST. THE REVISED FORECASTS ARE STILL IN THE NEIGHBORHOOD OF 5 PERCENT -- END FYI.)

4. MIYAZAKI SAID EPA EXPECTED 7 PCT GROWTH TO BE ACCOMPLISHED BY A REDUCTION IN CURRENT ACCOUNT SURPLUS BY ONE-THIRD FROM ITS 1977 LEVEL. HE EXPRESSED SOME CONCERN THAT THE RENEWED APPRECIATION OF THE YEN MIGHT DELAY

CONFIDENTIAL

CONFIDENTIAL

PAGE 04 STATE 110561

REDUCTION OF THE SURPLUS. HE NOTED THAT EXPORT VOLUME WAS UP IN JAN AND FEB AFTER LEVELING OFF IN LATE 1977. HE THOUGHT SOME INCREASES MIGHT BE IN ANTICIPATION OF SUCH EVENTS AS POSSIBLE FURTHER YEN APPRECIATION AND A WEST COAST DOCK STRIKE AND SOME MAY BE RESULT OF EFFORTS TO KEEP UP PRODUCTION TO KEEP DOWN UNIT COSTS. HE EXPECTED IMPORTS TO RECOVER GRADUALLY IN LINE WITH FASTER GROWTH, PARTICULARLY SINCE INVENTORIES WERE IN BETTER BALANCE.

5. IN RESPONSE TO QUESTIONS, JAPANESE SIDE SAID GOJ DID NOT BELIEVE TAX-CUTS TO STIMULATE CONSUMPTION WAS AN APPROPRIATE POLICY RESPONSE TO THE HIGH SAVINGS RATES, WHICH ARE EXPECTED TO ENDURE. THEY STRESSED UNMET SOCIAL INFRASTRUCTURE, INCLUDING HOUSING, DICTATED A NEED FOR CONTINUED HIGH PUBLIC INVESTMENT BOTH AS SHORT-RUN DEMAND MANAGEMENT POLICY AND A MEDIUM-TERM STRATEGY.

THE TAX BURDEN WOULD HAVE TO RISE TO MEET THIS SPENDING, THOUGH BOND FINANCING WOULD CONTINUE HIGH. MIYAZAKI SAID MUCH STUDY REMAINS TO BE DONE, BUT THE TIME PROBABLY IS COMING WHEN CONSIDERATION WOULD HAVE TO BE GIVEN TO SOME FORM OF INDIRECT TAX.

6. SECOND-DAY SESSION WITH EPA OPENED WITH A PRESENTATION BY NORDHAUS ON U.S. ENERGY POLICY AND OUTLOOK. HE NOTED THAT OVER LAST FOUR YEARS RETAIL PETROLEUM PRODUCT PRICES IN U.S. HAD RISEN AT 13 PERCENT AVERAGE RATE AND WERE NOW CLOSE TO WORLD LEVELS. GASOLINE, HOWEVER, IS AN EXCEPTION TO THIS. SOME CONSERVATION HAS BEEN INDUCED BUT RESULTS TO DATE ARE DISAPPOINTING AND MOST STUDIES SHOW VERY LONG LAG IN THE RESPONSE TO PRICE INCREASES. DETAILED DISCUSSION OF VARIOUS ESTIMATES OF U.S. ENERGY TRENDS UNDER A VARIETY OF ASSUMPTIONS FOLLOWED. JAPANESE SIDE AGAIN

CONFIDENTIAL

CONFIDENTIAL

PAGE 05 STATE 110561

EXPRESSED STRONG INTEREST IN THE IMPACT OF ALASKAN OIL AND STOCKBUILDING ON U.S. PETROLEUM IMPORTS IN 1978. SUBSEQUENTLY EPA DETAILED THEIR ESTIMATES OF JAPANESE ENERGY TRENDS. MOST NOTEWORTHY WAS INTENTIONS FOR VERY LITTLE CONVERSION TO COAL FOR ELECTRICAL GENERATION -- ONLY 5 PERCENT OF TOTAL BY 1990.

7. EPA PRESENTED THEIR ASSESSMENT OF POTENTIAL OUTPUT FOR JAPAN OVER THE NEXT SEVERAL YEARS. PROJECTIONS OF POTENTIAL TOOK 1975 AS A STARTING POINT, WHEN EPA ESTIMATES ACTUAL OUTPUT WAS 11-13 PERCENT BELOW POTENTIAL. THEY BEGAN WITH ESTIMATES OF LABOR FORCE GROWTH AND TWO SCENARIOS FOR INVESTMENT. ESTIMATED PRODUCTION FUNCTIONS WERE USED TO CALCULATE PATHS OF POTENTIAL. FOUR PRODUCTION FUNCTION ESTIMATES WERE PRESENTED AND ESTIMATES OF

POTENTIAL OUTPUT GROWTH WERE GIVEN FOR THREE OF THEM. THESE ESTIMATES RANGED FROM 3.2 PERCENT TO 5.5 PERCENT OVER THE PERIOD 1975-1985. THE OMITTED PRODUCTION FUNCTION WAS IN MANY RESPECTS MORE REASONABLE THAN THE ONES USED AND BY A QUICK CALCULATION WOULD HAVE YIELDED GROWTH IN POTENTIAL OF NEARLY 9 PERCENT. THUS THE EXERCISE APPEARED TO HAVE BEEN BIASED TOWARDS OBTAINING LOW ESTIMATES OF POTENTIAL GROWTH, BUT NO ATTEMPT WAS MADE TO HIDE THIS FACT.

8. AFTERNOON SESSION OF SECOND DAY WITH EPA CONCENTRATED ON EFFECTS OF EXCHANGE RATE CHANGES ON BALANCE OF PAYMENTS AND ECONOMIC ACTIVITY. JAPANESE SIDE REVIEWED DEVELOPMENTS IN 1977, NOTING THEIR ORIGINAL FORECAST OF \$700 MIL CURRENT ACCOUNT DEFICIT HAD BEEN PREDICTED ON EXCHANGE RATE OF YEN 300/\$1 AND STRONGER INDUSTRIAL ACTIVITY IN JAPAN. EVEN IF THESE FACTORS HAD BEEN CORRECTLY PREDICTED, MODEL WOULD HAVE UNDERPREDICTED CURRENT ACCOUNT SURPLUS BY 25 PERCENT, A DISCREPANCY WHICH EPA IS STILL ANALYZING. ACCELERATION AND SLOWING OF IMPORTS DURING PERIOD OF RAPID EXCHANGE RATE MOVEMENT WAS SUGGESTED AS A POSSIBLE EXPLANATION.

CONFIDENTIAL

PAGE 06 STATE 110561

TION. THERE WAS GENERAL AGREEMENT THAT EXCHANGE RATE APPRECIATION SHOULD ULTIMATELY WORK TO REDUCE THE CURRENT ACCOUNT SURPLUS ALTHOUGH THE LAGS MAY BE LONG AND THE FEEDBACK ON DOMESTIC COMPOSITION OF INVESTMENT (LABOR SAVINGS, POLLUTION CONTROL), EPA DID NOT THINK EFFECT OF YEN APPRECIATION WOULD HAVE MUCH OF A DAMPENING EFFECT ON DOMESTIC INVESTMENT.

9. EPA NOTED THAT THEIR SHORT-RUN FORECASTING MODEL SP-18 IS CONSTANTLY UPDATED -- ALMOST MONTHLY, AND THE LATEST REVISIONS HAVE INCORPORATED NEW LAG ESTIMATES. A COPY OF THE LATEST UPDATE WAS PROVIDED.

10. SCHULTZE INFORMALLY SUGGESTED TO MIYAZAKI THAT CEA/EPA MEETINGS SHOULD BE HELD AGAIN NEXT SPRING IN WASHINGTON. CHRISTOPHER

CONFIDENTIAL

NNN

## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 jan 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** ECONOMIC CONDITIONS, MEETING REPORTS, ECONOMIC PROGRAMS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 01 may 1978  
**Decaption Date:** 01 jan 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 20 Mar 2014  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1978STATE110561  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** JSHAFFER  
**Enclosure:** n/a  
**Executive Order:** GS  
**Errors:** N/A  
**Expiration:**  
**Film Number:** D780185-1127  
**Format:** TEL  
**From:** STATE  
**Handling Restrictions:** n/a  
**Image Path:**  
**ISecure:** 1  
**Legacy Key:** link1978/newtext/t197805105/aaaadtj.tel  
**Line Count:** 233  
**Litigation Code IDs:**  
**Litigation Codes:**  
**Litigation History:**  
**Locator:** TEXT ON-LINE, ON MICROFILM  
**Message ID:** 62a4a494-c288-dd11-92da-001cc4696bcc  
**Office:** ORIGIN CEA  
**Original Classification:** CONFIDENTIAL  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 5  
**Previous Channel Indicators:** n/a  
**Previous Classification:** CONFIDENTIAL  
**Previous Handling Restrictions:** n/a  
**Reference:** n/a  
**Retention:** 0  
**Review Action:** RELEASED, APPROVED  
**Review Content Flags:**  
**Review Date:** 10 may 2005  
**Review Event:**  
**Review Exemptions:** n/a  
**Review Media Identifier:**  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**SAS ID:** 2528963  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** CEA TALKS WITH ECONOMIC PLANNING AGENCY, APRIL 14- 15  
**TAGS:** ECON, EFIN, JA, US  
**To:** TOKYO  
**Type:** TE  
**vdkgvwkey:** odb://SAS/SAS.dbo.SAS\_Docs/62a4a494-c288-dd11-92da-001cc4696bcc  
**Review Markings:**  
Sheryl P. Walter  
Declassified/Released  
US Department of State  
EO Systematic Review  
20 Mar 2014  
**Markings:** Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014